Supreme Court, U.S.
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No. 98-1971

In The

Supreme Court of the United States

DANIEL ROBINSON, ET AL.,

Petitioners,

v.

ADMINISTRATIVE COMMITTEE OF THE SEA RAY EMPLOYEE'S STOCK OWNERSHIP AND PROFIT SHARING PLAN, ET AL.,

Repondents,

and

SHARON BALDOCK, ET AL.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF IN OPPOSITION FOR RESPONDENTS SHARON BALDOCK, ET AL.

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QUESTION PRESENTED

Whether the Magistrate Judge, district court, and Sixth Circuit properly determined, on the basis of well-settled law and uncontested facts established through the parties' cross-motions for summary judgment, that respondents' determination that no partial termination of the Plan had occurred was not arbitrary and capricious but reasonable and correct.

RULE 29.6 STATEMENT

Respondents are not corporations. Respondents are present and former Sea Ray employees who are or were participants in the Sea Ray Employees Stock Ownership and Profit Sharing Plan.

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STATEMENT

This action was initiated by Respondents, the Administrative Committee (the "Committee") of the Sea Ray Employees' Stock Ownership and Profit Sharing Plan (the "Plan") and individually the members of said Committee, William J. Barrington, Diane M. Yaconetti, and William R. McManaman, by the filing of a class action complaint for declaratory judgment in the United States District Court for the Eastern District of Tennessee Northern Division. The primary issue involved a determination as to whether the Committee was correct in its prior finding that a partial termination of the Plan had not occurred during Plan fiscal years 1989 and 1990 as a result of a significant reduction in the workforce of the sponsoring employer and the resulting reduction in the number of participants in the Plan. Following the filing of cross-motions for summary judgment by the parties the district court adopted the extensive and comprehensive report of the Magistrate Judge and entered a finding that a partial termination had not occurred. Substantial deference was given to the determination of the Committee pursuant to the arbitrary and capricious standard of review applied by the district court under the standards of *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989). A panel of the Sixth Circuit Court of Appeals unanimously affirmed the lower court's decision by finding that the proper standard of review had been applied. A subsequent request for en banc hearing was denied. This Court is now asked to reverse the consistent and comprehensive findings of the lower courts. Such action is not justified.

It should be here noted that Respondent Class II has a similarity of interest with Respondent Committee. As a

result Class II is familiar with the brief filed on behalf of the Committee and in this response brief may make reference to the appendices contained therein.

1. The Sea Ray Employees' Stock Ownership and Profit Sharing Plan

The Plan is a combination Employee Stock Ownership Plan ("ESOP") and Profit Sharing Plan qualified under the Employee Retirement Income Security Act ("ERISA"), 20 U.S.C. §§ 1002(3), (34) and the Internal Revenue Code (the "Code"), 26 U.S.C. § 401 et seq. As a result of such qualification the sponsoring employer, Ray Industries, Inc. ("Sea Ray"), may make annual contributions to the Plan on behalf of its participating employees and deduct those contributions as salary expense for federal income tax purposes. Employees are not permitted to make elective deferrals of salary or compensation into the Plan. All contributions are invested in either qualifying employer securities (typically stock of the sponsoring employer or its parent company) or diversified investments. Pet. App. 3, 22.

An employee becomes a participant in the Plan after one year of service with the sponsoring employer. Each participant has an individual account that receives allocations of the annual contributions based upon a formula contained in the Plan. Due to the qualified status of the Plan under ERISA and the Code the employees are not required to recognize income on these contributions until the assets are distributed outright to the employee upon termination of service with the sponsoring employer. Pet. App. 3-4. The accounts are maintained in a trust which is

a tax-exempt entity under the Code. As a result any income generated by the assets of the trust is not taxed until distribution of the account to the individual plan participant. 26 U.S.C. § 402. No additional benefits are provided to the participants under the Plan. Upon termination of employment with the sponsoring employer a participant is entitled only to the distribution of his/her account. Pet. App. 3.

Participants are not automatically entitled to the entire balance of their account upon termination of employment. The Plan employs the following incremental vesting schedule as permitted under the Code:

Years of Service	Vested Percentage
Less than 3 years	0%
3 years	20%
4 years	40%
5 years	60%
6 years	80%
7 or more years	100%

Plan § 10; Pet. App. 3-4; 26 U.S.C. § 411; Treas. Reg. § 1.411.

If a participant terminates service with the sponsoring employer prior to the completion of seven years of service with the company, the nonvested portion of the participant's account is forfeited and reallocated among the remaining participants in the Plan. Plan §§ 6, 10; C.A. App. 52, 60; Pet. App. 4, 23.

Pursuant to the qualification requirements of the Code, the Plan contains a provision addressing the effect of a partial termination of the Plan. In such case each participant would immediately become 100% vested in

his/her individual account balance regardless of the years of service rendered to that date. 26 U.S.C. § 411(d)(3), Plan § 19, Pet. App. 4, 100.

The Plan is administered by the Committee which is given a broad grant of administrative authority. In particular, Section 16(c) of the Plan provides:

> The Committee shall have all powers necessary to enable it to administer the Plan . . . including without limitation the following:
>
> (1) resolving all questions relating to the eligibility of Employees to become Participants;
>
> (2) determining the appropriate allocations to Participants' Accounts . . . ;
>
> (3) determining the amount of benefits payable to a Participant . . . , and the time and manner such benefits are to be paid;
>
> (7) construing and interpreting the Plan . . . and adopting rules for administration of the Plan that are consistent with the terms of the Plan documents and of ERISA and the Code. . . .

Plan § 16(c).

The Committee has consistently consulted with legal counsel to insure that all issues are properly and adequately addressed and to determine the full scope of its authority and discretion. Pet. App. 84-86.

The Plan is on a July 1 to June 30 fiscal year.

Section 19 of the Plan provides that if "the Plan is terminated (or partially terminated) . . . the Accounts of

Employees affected by the termination will become non-forfeitable as of the date of termination. . . . " This provision is required pursuant to the Code and to ERISA for qualification as a tax-exempt trust and plan. Pet. App. 100; 26 U.S.C. § 411(d)(3); 29 U.S.C. §§ 1001-1461.

2. Recent History of Plan and the Sponsoring Employer.

Sea Ray is a manufacturer and marketer of fiberglass recreational boating craft producing a full line of product from sport boats to luxury motor yachts. The recreational nature of the product line results in consumer decisions that are highly discretionary in nature and sensitive to overall economic conditions. There are no other product lines and no manufacturing capability in areas other than boat manufacturing. Pet. App. 3, 28; C.A. App. 871.

During the 1980's the boating industry in the United States experienced an unprecedented growth cycle. From 1983 to 1986 annual sales grew at an average rate of 35% per annum. This was reflected in Sea Ray's own sales performance. Pet. App. 27. This growth accelerated even further in 1987 and 1988. However, in calendar year 1989 Sea Ray noticed a small drop in total sales followed by a major and significant reduction in sales during calendar years 1990 and 1991.

Year	Units Sold
1985	12,456
1986	15,916
1987	22,355
1988	24,538
1989	23,214
1990	14,343
1991	10,542

Pet. App. 30.

The number of participants in the Plan naturally followed the sales of the company as the workforce was increased to meet the higher production requirements of the mid to late 1980's. At the beginning of the growth cycle Sea Ray was operating production facilities at seven locations. By July 1, 1989 the company had thirteen manufacturing facilities in operation. On July 1, 1985 there were 1,501 participants in the Plan. Pet. App. 27. By July 1, 1989 there were 3,832 plan participants. *Id.* at 27.

The drop in sales affected the entire product line except for the luxury motor yachts, the sales of which initially remained stable. However, in 1990 a federal "luxury tax" was implemented which was designed to be applied based upon the price and character of certain consumer products. The luxury motor yachts were within the price range characterizing these consumer products and therefore were subject to the tax. This tax had an immediate effect upon sales in this product line resulting in decreased sales and production of these items. *Id.* at 4-5, 29, 65.

The drop in sales resulted in a reduction of production and a corresponding decrease in employees and Plan participants. An initial reduction was implemented in

March and April of 1989. Sea Ray initially attempted to minimize the layoffs and stabilize the workforce, however, as sales figures for July, August and September were analyzed additional layoffs were deemed necessary and were announced in November 1989. One plant was closed and operations were consolidated and streamlined at other plants. The reduction in workforce was reflected in the December 1989 and January 1990 employment statistics. *Id.* at 31-34.

Employment was stabilized from February through June of 1990 when the number of plan participants stood at 3,060. Complt. ¶ 52, Pet. App. 29. The total number of plan participants for fiscal year 1990 was 4,084 computed by reference to the number of participants as of the beginning of the fiscal year (July 1, 1989), 3,832, plus the number of participants added during the year, 252. Pet. App. 38-39.

As a reaction to the continued slump in sales and projected orders from dealers, terminations were once again initiated in July, 1990 and continued on a periodic basis though the remainder of calendar year 1990 with the closing of two additional facilities. Pet. App. 34-37.

In the later portions of calendar year 1990 Congress passed and the President signed into law the aforementioned luxury tax. As of the beginning of the 1991 fiscal year (July 1, 1990) the Merritt Island, Florida and Palm Coast, Florida manufacturing facilities had among their employees 841 plan participants, only 30 fewer participants than were in the Plan on June 30, 1989. However, on June 30, 1991 these two facilities had only 538 plan participants remaining. Pet. App. 38. A disproportionate

percentage of the workforce reduction at these facilities occurred in fiscal year 1991. This corresponded to the passage and implementation of the luxury tax.

The total number of participants during fiscal year 1991 was 3,111 computed by reference to the number of participants as of the beginning of the fiscal year (July 1, 1990), 3,060, plus the number of participants added during the year, 51. Pet. App. 39. As of June 30, 1991, the end of the time frame here in question, the number of plan participants had declined to 1,968. Complt. ¶ 53; Pet. App. 29-30. For the two year time frame July 1, 1989 through June 30, 1991 the total number of plan participants had declined from 4,139 to 1,968. *Id.*

3. Administrative Determinations of Plan Committee.

As a result of the reductions in plan participation associated with the contraction of the sponsoring employer's workforce, the Committee initiated a review of the status of the Plan pursuant to the authority granted the Committee under Section 16 of the Plan. The primary purpose of these deliberations was to determine if a partial termination of the Plan had occurred. Pet. App. 84-86. The review of the Committee extended over two separate meetings in June 1992 during which the Committee sought the advice of legal counsel to insure that a full and complete evaluation was performed. *Id.* A number of factors were taken into account by the Committee including the percentage of participants terminated, the causative events triggering the reduction in force, and the absence of any financial benefit to the

sponsoring employer. *Id.* As a result of these deliberations the Committee determined that a partial termination of the Plan had not taken place.

4. Proceedings of the Lower Courts.

The Committee initiated this action by the filing of a complaint for declaratory judgment in the United States Federal Court for the Eastern District of Tennessee Northern Division. In that complaint the Committee asserted the existence of two separate classes of defendants and asked the court to certify each class. Under order of said court dated April 13, 1993 the two classes were defined as follows:

> Class I: All former Sea-Ray employees who were participants in the Plan and whose service as employees ended between July 1, 1989 and June 30, 1991, and who had an interest in the plan that was not fully vested, as well as the beneficiaries of those former Sea-Ray employees; and
>
> Class II: All present and former Sea-Ray employees who are or were participants in the plan and who may be entitled under the terms of the plan to receive a portion of the forfeitures resulting from the termination of employment of members of Class I, as well as the beneficiaries of those present and former Sea-Ray employees.

Pet App. 21-22.

The Committee seeks a declaration (i) that a partial termination of the Plan has not occurred as the result of the loss of plan participants; (ii) that the members of Class I are not therefore entitled to the accelerated vesting of their previously nonvested account balances; and (iii) that the nonvested balances of the members of Class I are to be deemed forfeited upon their termination of employment and such balances are to be reallocated to the continuing participants of the Plan pursuant to the provisions of the Plan.

Class I is the petitioner in this action. Class II and the Committee are the co-respondents. Following limited discovery, as agreed in informal pre-trial conference, the parties filed cross-motions for summary judgment. Said motions and subsequent oral arguments were heard by United States Magistrate Judge Thomas S. Phillips pursuant to order of reference entered by the district court. Pet. App. 20. The Magistrate Judge issued an exhaustive and comprehensive 79 page report which recommended to the district court that the summary judgment motions of the Committee and Class II be granted and that the motion of Class I be denied. *Id.* at 19, 88.

In the first step of his review the Magistrate Judge set forth the appropriate standard of review of the Committee's action. Citing *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989) the Magistrate Judge determined that the findings of the Committee would not be disturbed unless it was determined that they had been arbitrary and capricious. In applying the *Bruch* standard the Magistrate Judge found that Section 16(c) of the Plan gave the Committee the discretion and authority to construe and interpret the Plan and to determine the benefits payable to the

Plan participants. The Magistrate Judge reasoned that such authority logically extends to the determination of whether a partial termination has taken place pursuant to Section 19 of the Plan. Pet. App. 44-45. As a result of the discretion granted to the Committee in determining the occurrence or nonoccurrence of a partial termination the arbitrary and capricious standard was found to be appropriate. *Id.*

Upon setting the standard of review the Magistrate Judge proceeded in a review and analysis of the facts and circumstances surrounding the constriction of the Plan and the application of these factors to the standard of law. In doing so reference was made to both regulatory and judicial authority including administrative and regulatory rulings issued by the Internal Revenue Service, internal guidance provided by the Service to its agents, and case law originating from both within and outside of the Sixth Circuit. *Id.* at 47-79.

There were two areas of significant controversy which were resolved by the Magistrate Judge in making his decision. The first involved whether multiple triggering events had occurred which justified dividing the two plan years constituting the 1989-1991 time frame into two separate testing periods. The second involved the question as to whether all terminations (voluntary, involuntary, retirement, disability and termination for cause) should be used in computing the percentage of plan participants terminated in relation to the triggering events. *Id.*

The Magistrate Judge concluded that there were in fact two separate triggering events (referred to as "corporate events"). The first was the initial falloff of sales in the recreational boating line pursuant to a decline in the overall economic environment. The second was the advent of the luxury tax and its effect on the luxury motor yacht sales. However, this finding was not solely based upon the second triggering event. The Magistrate Judge specifically cited judicial and regulatory authority for segregating the time frame in question into multiple years for the computation and analysis of the percentage of terminated participants (the "significant percentage") when participant terminations are the result of industry volatility and occur in a multi-year time frame. *Id.* at 65.

The Magistrate Judge further concluded that in computing the significant percentage of employees terminated in relation to the triggering event, the court would not count those employees who retired, died, became disabled, were terminated for cause or who left voluntarily as having been terminated in relation to the triggering event(s) and therefore were not to be included as terminated employees. *Id.* at 65-76.

The Magistrate Judge determined that there were no factors present other than the numerical contraction of the Plan upon which a finding of partial termination could be based. He further concluded that the percentage of plan participants terminated pursuant to the triggering events was insufficient to support such a finding. *Id.* at 87. Based upon these considerations the Magistrate Judge made his finding as set forth above.

The district court accepted the report and recommendation of the Magistrate Judge and found that the report "was clearly correct" in applying the arbitrary and capricious standard of review. The district court itself conducted a *de novo* review of the record and agreed that the percentage of plan participants terminated was insufficient to justify a finding that a partial termination had occurred. *Id.* at 17. The motions of the Committee and Class II for summary judgment were granted. *Id.* at 19.

The Sixth Circuit reviewed the district court's grant of summary judgment *de novo*. The district court's decision was upheld by unanimous decision of a three judge panel. *Id.* at 9. Specifically the court of appeals determined that the Plan did give the Committee the requisite discretionary authority to determine whether a partial termination had taken place thereby triggering the arbitrary and capricious standard of review. *Id.* at 9-10. The court of appeals approved and adopted the percentages and methodology applied by the district court and Magistrate Judge. *Id.* at 12-14. Finally, the Sixth Circuit found that the Committee's determination "was neither arbitrary nor capricious" and that a partial termination of the Plan had not occurred as a result of the reduction in plan participants during the time frame in question. *Id.* at 15.

Petitioners' subsequent request for *en banc* rehearing was denied. *Id.* at 94-95.

REASONS FOR DENYING THE PETITION

The petition for certiorari asserts that the issues presented are proper for consideration by this Court due in

part to errors by the lower courts in the interpretation and consideration of various factual matters and due in part to conflicts between the circuits on questions of law. Petitioners' position is not justified in either case. The issues presented for review by this Court do not warrant further consideration for the reasons set forth below.

I. THE SIXTH CIRCUIT AND THE DISTRICT COURT PROPERLY APPLIED THE STANDARDS OF *FIRESTONE TIRE & RUBBER CO. V. BRUCH.*

A. Application of the Arbitrary and Capricious Standard of Review.

Petitioners assert error in the Sixth Circuit's finding that the Plan grants the requisite discretionary authority to support judicial deference to the determinations of the Committee. Additionally, Petitioners claim that the standards as set forth by the Sixth Circuit are in conflict with the holdings of other circuits. Pet. 9-11. However, the attempts by Petitioners to demonstrate these conflicts only show Petitioners' own failure to fully comprehend the holding of this Court in *Firestone Tire & Rubber Co.*, 489 U.S. at 115. In the *Firestone* decision this Court ruled that "a denial of benefits . . . is to be reviewed under a *de novo* standard unless the benefit plan gives the administrator or fiduciary discretionary authority to determine eligibility for benefits or to construe the terms of the plan." *Id.* at 115.

The difficulty for Petitioners is that this Court did not require that the grant of discretionary authority be dependent on the incantation of the word "discretion" or some other magic word. Instead this Court directed lower

courts to focus on the breadth of the administrators' power and their "authority to determine eligibility for benefits or to construe the terms of the plan." *Id.*

Petitioners seek to demonstrate conflict between the circuits by the citation of a series of cases with single sentence summaries of the various holdings. Pet. 10. Such an exercise is overly simplistic and the claimed conflict disappears upon complete review of the cases and their holdings. While space does not permit a full review of the authority cited by Petitioners, any apparent conflict is typically the result of factual differences rather than interpretive decisions of law by the courts.

A majority of the cases in this arena deal with denial of benefits by a plan to one or more participants. A significant number of these cases involve health care, disability or death benefits provided by an employer or third party insurance provider. *Perez v. Aetna Life Ins. Co.*, 150 F.3d 550 (6th Cir. 1998) (*en banc*) (denial of long-term disability benefits); *Cathey v. Dow Chem. Co. Medical Care Program*, 907 F.2d 554 (5th Cir. 1990) (termination of long-term nursing care benefits); *Moon v. American Home Assurance Co.*, 888 F.2d 86 (11th Cir. 1989) (denial of claim for accidental death benefits); and *Baxter By and Through Baxter v. Lynn*, 886 F.2d 182 (8th Cir. 1989) (subrogation claim related to employee who had previously obtained benefits from health plan). These cases rarely involve the interpretation of a benefit plan that has the comprehensive structure of the Plan which was drafted with the intention of being employer sponsored and administered.

As a result the lower courts have labored in determining whether empowerment clauses tailored to narrow

claims issues provide discretionary authority to the plan administrator sufficient to avoid *de novo* review and support the deferential capricious and arbitrary standard of review. This has been especially true when the empowerment clause is examined within the context of the plan instrument as is present in much of the authority cited by Petitioners. For instance, in *Kirwan v. Marriott Corp.*, 10 F.3d 784 (11th Cir. 1994) a discharged employee was seeking long-term disability benefits under an employee benefit plan. The plan fiduciary claimed that its decision should be reviewed under the arbitrary and capricious standard because the plan stated that the fiduciary had "authority to control and manage the operation and administration of the Plan." The Eleventh Circuit noted that

> Marriott may 'control and manage' the Plan, but it must do so in accordance with the terms of the Plan and there is *no grant of authority to construe these terms*. . . . The Plan contemplates that the administrator will determine whether a benefit is properly payable; however, there is no grant of discretion to accompany this mandatory function. . . .

(Emphasis added.) *Id.* at 789. The Eleventh Circuit holding is a strict application of the *Firestone* standard but it is consistent with the overall approach by the courts in taking the grant of authority in the context of the plan instrument. Despite Petitioners' assertions to the contrary, the Sixth Circuit has applied the same sort of reasoning by stating that "discretion is not an all-or-nothing proposition. A plan can give an administrator discretion with respect to some decisions but not others. . . . A plan

administrator has exactly the amount and type of discretion granted by the plan, no more, and no less." *Anderson v. Great West Life Assurance Co.*, 942 F.2d 392, 395 (6th Cir. 1991).

Petitioners assert the existence of conflict between the circuits by specific citation to two cases. The first is the 6th Circuit's *en banc* decision in *Perez v. Aetna Life Ins. Co.*,150 F.3d 550 (6th Cir. 1998) (*en banc*). The second is the Ninth Circuit's *en banc* decision in *Kearney v. Standard Ins. Co.*, ___ F.3d ___, Nos. 96-16539, 96-16701, 1999 WL 246485 (9th Cir. 1999). Both cases involve the denial of disability insurance claims by the insurance providers acting as third party administrators of an employer's disability plan. While it is true that the circuits disagreed on the construction of similar language contained in the plans that disagreement can hardly provide justification for review of this action. The conflict in opinion stemming from the *Perez* and *Kearney* decisions involves the determination as to whether a requirement for "satisfactory written proof" of a disability confers discretion upon the plan administrator to determine if the disability exists. *Kearney*, at ___, 1999 WL 246485, at *5; *Perez*, 150 F.3d at 555-556.

Such disagreement can in no way be applicable to the fact pattern presented in this case. As set forth above, the Plan was a complete and comprehensive employee benefit plan drafted so as to qualify under both ERISA and the Internal Revenue Code. Such plans are highly technical in nature and are subjected to Internal Revenue Service approval through the filing of qualification applications with the Service before they are granted tax qualified

status. 26 U.S.C. § 401. The scope of authority and discretion necessary to properly administer such a plan must and should be significant. This properly provides a context for the analysis of a specific grant of authority and the intended scope of such grant.

However, the most surprising aspect of Petitioners' application is their assertion that by the circuit court's decision in this case the Sixth Circuit is in conflict with itself. Pet. App. 13. To make this argument Petitioners are once again attempting to draw broad conclusions from judicial determinations that were intensely factual. The case cited by Petitioners is *Wulf v. Quantum Chem. Corp.*, 26 F.3d 1368 (6th Cir. 1994).

The *Wulf* case involved the review of a determination of a plan administrator as to the amount of plan benefits to be distributed to the employees based upon their termination of employment resulting from the sale of the plant where the employees worked. Pursuant to the original provisions of the plan in question the terminated employees were entitled to the vested portions of their plan accounts. The sponsoring employer, however, retroactively amended the plan so as to reduce the value of the employees' vested benefit and the plan administrator sought to value the accounts in accordance with the amendment. *Id.* at 1370-1371. The administrator claimed that the arbitrary and capricious standard of review was appropriate due to the authority granted under the plan whereby "the Committee from time to time shall establish rules for the administration of the Plan and the transaction of its business. The determination of the Committee as to any disputed questions shall be conclusive." *Id.* at 1373. Citing *Anderson v. Great West Life Assurance Co.* the

Court rejected the position of the plan administrator and noted the absence of any discretionary language specifically related to the issues attendant to the disputed transaction. *Id.*

In this action the grant of authority under the Plan specifically gave the Committee "all powers necessary . . . to administer the Plan," but more importantly also the authority to determine the eligibility of "Employees to become Participants," to determine "the amount of benefits payable to a Participant," and most significantly the power to construe and interpret "the Plan and the Trust Agreement ." Plan § 16(c). The court of appeals found such language to be a sufficient grant of discretionary authority not because of any individual phrase or magic word but because of the context and scope of the grant of power. Pet. App. 9-10. The determination of the Sixth Circuit was well-reasoned and well-based in precedent both outside and within the circuit. The finding of the court of appeals was solidly grounded in the principles of *Firestone*. The arbitrary and capricious standard of review was properly applied and should not be the basis for review by this Court.

B. Does the Existence of Either a Question of Law or a Question of Fact Require De Novo Review?

1. Question of Law

Petitioners contend that since a determination of partial termination relies upon an interpretation of a federal statute, specifically 26 U.S.C. § 411(d)(3), the courts should not grant deference to such determinations. This

argument turns *Firestone* completely upon its head particularly with respect to judicial review of retirement plans under ERISA and the Code. As noted above these types of plans are highly regulated and are typically composed of a series of provisions which are specifically required under the Code. A qualified retirement plan, whether it be a defined contribution plan, a defined benefit plan or a 401(k) deferral plan, is a statutory creation and heavily dependent upon statutory interpretation. If Petitioners' argument were to be adopted it would eviscerate the concept of an arbitrary and capricious standard of review.

The foregoing notwithstanding, a determination of whether a partial termination has occurred is primarily a factual issue. As set forth by treasury regulations, "Whether a partial termination of a qualified plan occurs . . . shall be determined . . . by the facts and circumstances in a particular case." Treasury Regulations § 1.411(d)-2(b). The Magistrate Judge noted that the primary factors for consideration were the size of the contraction, the resulting effect on the Plan, and the motive of the employer related to the reduction in employees. Pet. App. 82. In no case does this require an interpretation of statute or regulatory authority since both the Code and Treasury Regulations are silent as to the weight or priority to be given any individual factor.

The court of appeals specifically considered the arguments offered by Petitioner regarding the preclusionary effect of a question of law on the standard of review to be applied. The court clearly stated that such issue had been resolved in the Sixth Circuit under the holding of *Davis v. Kentucky Fin. Co. Retirement Plan,* 887 F.2d 689 (6th Cir. 1989). In adherence to that decision the court of appeals

here held that pursuant to the "grant of discretion" contained in the Plan, "the Committee possessed the power to interpret the language of terms in the plan." Pet. App. 10.

Petitioners cite *Weil v. Retirement Plan Admin. Comm'n*, 913 F.2d 1045 (2nd Cir. 1990), *rehearing*, 933 F.2d 106 (2nd Cir. 1991) (*Weil II*) and *Penn v. Howe-Baker Eng'rs, Inc.*, 898 F.2d 1096 (5th Cir. 1990) as evidence of error on the part of the court of appeals and as evidence of a split between the circuits. The series of decisions referred to as *Weil I, Weil II* and *Weil III* can offer little guidance. This series of appeals, all pertaining to the same initial cause of action, are remarkable in their lack of consistency and like *Penn* are considered to be more out of the mainstream of authority with the passing of each day and rarely cited in contemporary argument. For a more accurate statement of the law in the Second Circuit Respondents cite *Jordan v. Retirement Committee of Rensselaer Polytechnic Institute*, 46 F.3d 1264 (2nd Cir. 1995). The remaining cases cited by Petitioner are distinguishable from the basic premise for which they are offered.

For instance, in *Pratt v. Petroleum Prod. Management, Inc. Employee Sav. Plan & Trust*, 920 F.2d 651 (10th Cir. 1990) the Tenth Circuit examined the grant of discretionary authority contained in a qualified retirement plan. The court determined that the discretionary authority given to the plan administrator in the plan instrument was sufficient to justify a deferential standard of review. In its analysis of the standards of review the court of appeals stated that the decisions of a fiduciary are to be upheld unless they are "(1) arbitrary and capricious, (2)

not supported by substantial evidence; or (3) erroneous on a question of law." *Id.* at 657, citing *Sage v. Automation Inc. Pension Plan & Trust*, 845 F.2d 885, 895 (10th Cir. 1988) (quoting *Peckham v. Bd. of Trustees*, 653 F.2d 424, 426 (10th Cir. 1981)). By inference therefore, the mere presence of a question of law is insufficient to justify *de novo* review. Similarly, in *Gauer v. Connors*, 953 F.2d 97 (4th Cir. 1991) the Fourth Circuit was concerned with a technical interpretation of ERISA regulations and whether the plan administrator had made a clear error of law. *Id.* at 100.

Contrary to the arguments of Petitioners the mere existence of a question of law is insufficient to support de novo review. Rather there must be some demonstrated error in law committed by the fiduciary or plan administrator.

2. Question of Fact.

Respondent must admit to a level of fatigue with this argument. Petitioners first say there's not a sufficient grant of discretionary authority, give us *de novo* review. If there is discretion then there exists a question of law, give us *de novo* review. If no question of law exists then there is a question of fact, give us *de novo* review. Under Petitioners' systematic progression there is in fact no situation where the deferential standard would be applicable since Respondents cannot imagine a situation where there would not be either a question of law or a question of fact.

Petitioners raise this argument for the first time in these proceedings through their application. A review of

Section 16(c) of the Plan shows that the Committee is given the power to (1) resolve "all questions relating to the eligibility of the Employees to become Participants;" (2) determine "the appropriate allocations to Participants' Accounts;" and (3) determine "the amount of benefits payable to a Participant." Plan § 16(c). Each of these powers and the authority granted are dependent upon the accumulation and assimilation of information pertaining to the participants in the Plan. These tasks could not be performed unless the Committee was given the authority to accumulate the appropriate information, conduct an analysis of that information and render a determination.

While it may appear that Petitioners are attempting to assert that the facts of this matter are in controversy they did file the initial cross-motion for summary judgment thereby certifying that no factual dispute then existed and that the issues were proper for disposition by summary judgment. Any factual issues now raised are precluded by Petitioners' prior actions and are not proper for review by this Court.

C. Did the Sixth Circuit Improperly Consider Facts Which Did Not Originally Form the Basis of the Committee's Finding That a Partial Termination Did Not Occur?

Petitioners assert that the lower courts acted incorrectly in considering information in their decisions not available to the Committee at the time it made its determination that a partial termination had not occurred. This

argument is a result of the position advanced by Respondents in the lower courts whereby the significant percentages of terminations should be computed separately for each of the Plan years encompassed by the time frame July 1, 1989 through June 30, 1991. As noted above, the lower courts accepted this argument and determined that the terminations for each fiscal year of the Plan should be computed individually in developing a significant percentage for such year. Each year was then examined individually to determine if the significant percentage of terminations for that year was large enough to support a finding of partial termination in the absence of any additional enhancement factors. Pet. App. 12-13, 65. Petitioner states that this is a finding based on facts not considered by the Committee in its original determination. Pet. App. 18-20.

This is not totally accurate. The facts forming the basis of Respondents' argument were considered by the Committee. They were aware of the overall level of participant terminations and they were aware of the effect of the luxury tax upon the participants employed at the Merritt Island and Palm Coast facilities. Pet. App. 84-86. There were no additional facts presented to the court of appeals or the district court which were not available to and received by the Committee. As such the authority cited by Petitioners is inappropriate to the argument. The Sixth Circuit did not consider improper factual arguments and no basis exists for reviewing its decision under this line of reasoning. Within the Sixth Circuit this holding is consistent with the prior precedent of *Davis*, 887

F.2d at 689, whereby a court may uphold an administrator's decision even on grounds not given by the administrator.

II. DID THE COURT OF APPEALS PROPERLY APPLY THE CLEARLY ERRONEOUS STANDARD OF REVIEW TO THOSE CONCLUSIONS CRUCIAL TO THE HOLDING OF THE DISTRICT COURT?

Petitioners have essentially two arguments in advancement of this position. The first is the use of the second triggering event of the luxury tax as justification for separating the two year time frame examined by the lower courts into two separate testing periods and computing the significant percentage for each of these years separately. The second was the court of appeals' approval of the elimination of certain employee terminations from the computation of the significant percentage. Pet. App. 21.

Both of these arguments come from the same perspective. All parties have agreed, and the lower courts have ruled, that despite the multiple factors test advanced by regulation, Internal Revenue Service administrative rulings and the common law, the significant percentage can become so large as to be solely determinative of the issue of partial termination. *Id.* at 76; *Kreis v. Charles O. Townley, M.D. & Assoc., P.C.*, 833 F.2d 74 (6th Cir. 1987). As a result, Petitioners have consistently sought any and all means to maximize the significant percentage while Respondents have sought to minimize the significant percentage. The bifurcation of the 1989-1991 time frame into two separate testing periods

did have a significant effect upon the computation of the significant percentage. Pet. App. 80-81.

Petitioners have now argued for the first time that the luxury tax could not have the effect claimed by Respondents Class II since it was passed in late 1990 and did not become effective until January, 1991. It is implied that Class II misled both the Magistrate Judge and the court of appeals by the advancement of this position. However, an examination of the record will show that Respondents Class II clearly stated in their Memorandum in Support of Their Cross-Motion For Summary Judgment and in Opposition to the Class I Defendants' Motion for Summary Judgment that the luxury tax became effective on January 1, 1991. App. 9.

As noted above, the determination of the Magistrate Judge to bifurcate the testing period into two separate years was not based solely upon the second corporate event. Also cited was the recurring nature of such an event as characteristic of normal industry volatility as well as the multiple year nature of the contraction. The court relied upon two decisions of other courts in determining that bifurcation was permissible, *Tipton & Kalmback, Inc.*, 83 T.C. 154 (1984) and *Kreis*. Pet. App. 65. In contrast Petitioner continues to cite a single case, *In re Gulf Pension Litig.*, 764 F. Supp. 1149 (S.D. Tex. 1991) *aff'd sub nom., Borst Chevron Corp.*, 36 F.3d 1308 (5th Cir. 1994), for its position that bifurcation is improper. Unfortunately the precedential value of the *In re Gulf Litigation* is limited since the Fifth Circuit stated that in affirming the lower court the issue of partial termination had not been decided and that the district court's holding with

respect to that issue was not preclusive against the parties. *Id.* at 1314, n. 11.

Therefore, Petitioners are left asserting that the Sixth Circuit improperly affirmed the findings of the district court without offering any valid authority to the contrary. But more importantly even if this determination of the court of appeals is in error it would be harmless error since the aggregated significant percentage of participants terminated over the two year time frame would be 32.8%.

The second issue involves the court of appeals' affirmation of the district court's finding that certain employee terminations occurring during the July 1, 1989 to June 30, 1991 time frame were excludable from the computation of the significant percentage. These exclusions represented employees terminated for cause, employees terminated due to death or disability and employees who voluntarily terminated employment with the sponsoring employer but who failed to provide any reason for such termination. Pet. App. 12. It is this last group of terminated employees with which Petitioners are concerned. At all levels of review Petitioners have asserted that these voluntary terminations should be considered to have been constructively discharged as a result of the contraction of the Plan. Pet 26.; Pet. App. 12, 71-76.

Petitioners cite extensively from the Tax Court's opinion in *Halliburton Co. v. CIR*, 100 T.C. 216 (1993), *aff'd*, 25 F.3d 1043 (5th Cir.) which contains an extensive analysis of the issue of what employees make up the class of terminated employees for purposes of the computation of the significant percentage. However, neither regulatory

authority nor *Halliburton* supports the Petitioners to the extent they claim. Treasury Regulations imply that only employer-initiated terminations should be counted due to the use of the term "severance by the employer" of plan participants. Treas. Reg. §§ 1.411(d)-2(b)(1); *Halliburton* at 240. This would specifically exclude any employees whose employment was terminated for any reason not specifically attributable to employer action related to the corporate event. Generally, the courts have found this too stringent a standard and have acknowledged the possibility that a constructive discharge may take place in those circumstances where employees resigned either where intolerable working conditions are created by the employer or it is clear that there is no prospect for continued employment. *Kreis*, 833 F.2d at 81-82; *Collignon v. Reporting Serv. Co.*, 796 F. Supp. 1136, 1141-42 (C.D. Ill. 1992); *Morales v. Pan Am. Life Ins. Co.*, 718 F. Supp. 1297, 1303 (E.D. La. 1989) *aff'd*, 914 F.2d 83 (5th Cir. 1990). The Court in *Halliburton* concurred with these prior decisions and excluded these employees in its analysis but it also clarified the issue by stating

> [S]ome employees might leave their jobs of their own accord, even when economic situations are bad, because of dissatisfaction with their situations or for personal reasons. The partial terminations rule was not meant to protect such persons – they do not have the same expectation with respect to the vesting of their accrued benefits that involuntarily separated employees do. Moreover, vesting their benefits would not necessarily deter abuse by employers.

Halliburton at 241.

The Tax Court concluded that simple concern over the future was insufficient to sustain a claim of constructive discharge. The employer must have overtly and purposefully created a hostile and unbearable work environment or the employee must have actual notice that his employment is about to be terminated such as an actual closure notice.

The Sixth Circuit was even more stringent in *Kreis*

> The employee's perception of his situation is judged objectively. "An employee may not be unreasonably sensitive to his working environment. A constructive discharge occurs only when a reasonable person would find conditions intolerable."

Kreis, 833 F.2d at 82 (quoting *Henry v. Lennox Indus.*, 768 F.2d 746, 752 n. 3 (6th Cir. 1985) [quoting *Johnson v. Bunny Bread Co.*, 646 F.2d 1250, 1256 (8th Cir. 1981)]).

Petitioners seek to establish a judicial inference that penalizes a sponsoring employer when that employer is experiencing a cyclical downturn in economic performance by having all employee departures be counted against the employer under the theory that mere concern for job stability is sufficient for a finding of constructive discharge. This is a disincentive to employee loyalty in times of employer stress. Petitioners have offered no authority that would justify having the voluntarily terminated employees included in the numbers of employees terminated as a result of the significant corporate events.

Petitioners claim that the Sixth Circuit misapplied the standard of review and seek reversal due to the court of appeals' failure to hold the district court action to a more

stringent standard. However, Petitioners have not demonstrated where the Sixth Circuit was in error and have no authority upon which to base their assertions. There were no disputed facts as evidenced by the cross-motions for summary judgment. No error exists in the court of appeals' affirmation of the methodology applied by the district court. No conflicts exist between the circuits on the issues presented. In the absence of a factual dispute between the parties there was no basis for the court of appeals to reverse the findings of the district court.

III. CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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RESPONDENT'S EXHIBIT

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF TENNESSEE NORTHERN DIVISION

ADMINISTRATIVE COMMITTEE OF THE SEA RAY EMPLOYEES' STOCK OWNERSHIP AND PROFIT SHARING PLAN, et al.,	**Civ. # 3-92-0587**
Plaintiffs	**(Filed Mar. 4, 1996)**
v.	
DANIEL ROBINSON, et al.	
Defendants.	

CLASS II DEFENDANTS MEMORANDUM IN SUPPORT OF THEIR CROSS-MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO THE CLASS I DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

The Class II defendants, having filed a Cross-Motion for Summary Judgment and in response to the motion for summary judgment filed by the Class I defendants, submit this memorandum of law in support of their cross-motion for summary judgment and in opposition to the Class I defendants' motion for summary judgment.

I. INTRODUCTION

This action was initiated by the plaintiffs, the Administrative Committee of the Sea Ray Employees' Stock Ownership and Profit Sharing Plan (the "Committee") and William J. Barrington, Dianne M. Yaconetti, and William R. McManaman as members of the Committee, by

their Class Action Complaint as filed on August 25, 1992. The complaint requested declaratory judgment as to whether a "partial termination" had occurred with respect to the Sea Ray Employees' Stock Ownership Plan (the "Plan") within the meaning of the Internal Revenue Code ("IRC"), the Employee Retirement Income Security Act ("ERISA"), and the terms of the Plan.

The Plan is a combination Employee Stock Ownership Plan ("ESOP") and Profit Sharing Plan qualified under the provisions of the Internal Revenue Code and ERISA so as to allow the employer to make annual contributions to the Plan for its participating employees' benefit while deducting the contributions as salary expense for tax purposes. **IRC § 404.**

Under the terms of the Plan these contributions are invested and held in either qualifying employer securities or diversified investments and allocated to the individual accounts of the plan participants based on a predetermined allocation formula contained in the Plan's governing agreement. **See Treas. Reg. § 1.401-1(b)(1) (ii); Plan Section 5.** The participant is not required to recognize these allocations on his individual income tax return until the assets are distributed to him from the Plan. **IRC § 402.**

A participant does not necessarily own his account. His right to the account assets is determined in accordance with a vesting schedule as contained in the Plan's governing agreement. The vesting schedule attributes percentage ownership of a participant's account based on years of service rendered by the participant to the sponsoring employer.

There are two alternative vesting requirements under the Internal Revenue Code: (i) 5 year cliff vesting; and (ii) 3/7 vesting. **See Temp. Reg. 1.411-3T.** An employer may have a more liberal schedule such as a three year cliff (meaning that for three years the participant is 0% vested but after three years the participant is 100% vested) but it may not be more stringent.

The Plan used the 3/7 vesting schedule as follows:

Years of Service	Vested Percentage
Less than 3 years	0%
3 years	20%
4 years	40%
5 years	60%
6 years	80%
7 years	100%

See Plan Section 10.

If an employee/participant terminates service prior to becoming 100% vested then the participant receives only the portion of his account that is vested. The remaining amount is forfeited and reallocated to the remaining participants accounts based on the allocation formulas of the Plan. **Id.**

The complaint focused on corporate events of the sponsoring employer, Ray Industries, Inc. ("Sea Ray"), over a time frame that included all or parts of calendar years 1989, 1990 and 1991. In this time frame Sea Ray experienced a severe economic downturn that resulted in significant lay-offs in the Sea Ray workforce and correspondingly in the participants of the Plan. The central issue in this action is a determination as to whether such

constriction of the Plan's participants resulted in a partial termination of the Plan.

If a partial termination occurred, the account balances of all participants in the Plan became 100% vested as of the time of termination. **See Plan Section 19.** If a partial termination did not occur, then the non-vested portions of the accounts of those participants who were terminated as employees of Sea Ray during the economic downturn will be forfeited by those participants and the forfeited assets will be re-allocated among the remaining participants.

Therefore, the final determination as to whether a partial determination [sic] did occur will impact two groups of current and former Plan participants. The definition of these two groups has been the subject of extensive negotiation between legal counsel. The Order of this Court dated April 13, 1993 delineated two classes of participants for the purpose of initial examination, but reserved a final determination of the classes and time frame to be examined pending offer of proof by the parties. Under said Order Class I and Class II were defined as follows:

> Class I: All former Sea-Ray employees who were participants in the plan, and whose service as employees ended between July 1, 1989, and June 30, 1991, and who had an interest in the plan that was not fully vested, as well as the beneficiaries of those former Sea-Ray employees; and
>
> Class II: All present and former Sea-Ray employees who are or were participants in the plan and who may be

> entitled under the terms of the plan to receive a portion of the forfeitures resulting from the termination of employment of members of Class I, as well as the beneficiaries of those present and former Sea-Ray employees.

The time frame in question reflects two of the Plan's fiscal years based on the July 1 to June 30 fiscal year.

It should be noted that a mutuality of interest exists between the plaintiffs and the Class II defendants. By the plaintiffs' determination that a partial termination took place, Class II stands to receive the reallocation of the forfeited assets.

II. Facts

A. Employer History.

Sea Ray is a manufacturer and marketer of fiberglass recreational boating craft dating back to its inception in the 1950's. Since 1986, Sea Ray has been a wholly owned subsidiary of Brunswick Corporation as part of its Marine Group of manufacturing entities. The company has developed a full product line of pleasure craft from sport boats to luxury motor yachts. **Cmplt. § 49.** There are no other product lines. Since the entire manufacturing capacity is dedicated to leisure products the company is particularly sensitive to economic cycles. **Plaintiff's Ex. VI, Economic Intelligence Company, Report to Brunswick Corporation 1.**

During the 1980's the U.S. boating industry experienced a unprecedented growth cycle. From 1983 to 1986

annual sales grew at an average rate of 35%. **Id. at 5.** Sea Ray's own sales figures reflected these increases.

On July 1, 1985 Sea Ray was operating seven facilities: (i) Oxford Plant, Oxford, Michigan; (ii) Phoenix Plant, Phoenix Arizona; (iii) Merritt Island Plant, Merritt Island, Florida; (iv) Knoxville Plant, Knoxville, Tennessee; (v) Tellico Plant, Vonore, Tennessee; (vi) Palm Coast Plant, Palm Coast, Florida; and (vii) Ray Industries Corporate Headquarters, Knoxville, Tennessee.

To meet the increased demand during the 1980's Sea Ray added significant plant capacity by building new plants and purchasing already existing manufacturing facilities. By July 1, 1989 Sea Ray had expanded to thirteen facilities, the previously listed seven plus: (viii) Cherokee Cove Plant, Madisonville, Tennessee; (ix) Product Development & Engineering, Merritt Island, Florida; (x) Fort Mill Plant, Fort Mill, South Carolina; (xi) Transportation Division, Knoxville, Tennessee; (xii) Riverview Plant, Knoxville, Tennessee; and (xiii) Sykes Creek Plant, Merritt Island, Florida. Additionally, the company acquired a plant in Cork, Ireland which is not part of this action. **Deposition of William J. Barrington, President and CEO, Ray Industries, Ex. 1, pp. 73-84; and Cmplt § 50 & 51.**

In early 1989 a slight softening was detected in industry sales figures followed by a precipitous fall in late 1989. **See Plaintiffs' Ex. VI at 5.** Sea Ray suffered a significant drop in sales of all product lines except the luxury yachts. In 1990, the federal government instituted a luxury tax that targeted high ticket consumer goods such as automobiles, aircraft and yachts. As a result the

luxury yacht market suffered a drastic drop in sales. **Barrington Dep. pp. 39, 86.**

Sea Ray total sales for this entire time frame are as follows:

Year	Units Sold
1985	12,456
1986	15,916
1987	22,355
1988	24,538
1989	23,214
1990	14,343
1991	10,542

See Cmplt. § 49.

Sea Ray uses a marketing and sales mechanism that is based on input from dealers both on an annual projection and on quarterly updates. The annual projection was divided into quarters and the dealers were expected to purchase their quota in each quarter. **Barrington Dep. 124.** Sea Ray would then structure its manufacturing output to match these projections. During the projected year the dealers obtain their market product by a series of orders made at designated times. **Barrington Dep. 134.** The first indication that sales were underperforming would be an accumulation of inventory at the dealers level and a resultant drop in the quarterly orders.

Because of the continuous ordering structure, drops in sales become immediately evident subject to analysis of the data. **Id.** This allows Sea Ray to make rapid adjustments to production. However, there is a built in delay where production continues at the projected rather than

actual need and results in an increased impact on the workforce. **Barrington Dep. pp. 135-137.** The first noticeable drop in sales (33%) occurred in the months of March/April 1989 with the first announcement of layoffs coming in May, 1989. **Barrington Dep. 135.**

B. Effect on Plan Participants.

Not all employees were participants of the Plan. An employee becomes a participant of the Plan upon the completion of one full year of service (defined as a year in which the employee is credited as having 1000 hours of service). **Plan Section 3.**

On July 1, 1985 total number of Plan participants was 1,501. **See Cmplt. § 50.** By July 1, 1989, at the end of the expansion cycle, there were 3,832 Plan participants.

In reaction to the sudden drop in sales occurring in March/April 1989, Sea Ray issued official notices of temporary layoffs for 10% of the Tennessee workforce. **Class I Coll. Exh. 2.**

This proved inadequate when May sales figures reinforced the downward trend and in July, 1989, management announced the closure of the Cherokee Cove, Riverview and Ft. Mill plants. **Barrington Dep. 137.** The corporation attempted to stabilize the workforce and determine the extent of the downturn. However, sales figures for July, August and September confirmed the continuing drop in the market and additional layoffs were announced in November which were reflected in December, 1989 and January, 1990 employment statistics. **Id. at 138; Weekly Plant Comparisons, Ex. 2.**

Employment did stabilize at that point with only small reductions in workforce taking place for February through June of 1990. **Class I Ex. 7.**

By June 30, 1990, the number of Plan participants stood at 3,060. **Cmplt. § 52.**

The downward trend continued through 1990 into 1991 enhanced by the effect of the advent of the luxury tax which was effective as of January 1, 1991. At the beginning of the 1991 fiscal year (7/1/90), the Merritt Island and Palm Coast facilities, which produced the high end luxury yachts, were still employing 1037 employees, only 1 less than the 1038 employed on July 14, 1989. Due to the effects of the luxury tax, the June 30, 1991 employment at the two facilities had dropped to 583 persons. **Ex. 2.**

The number of Plan participants were similarly affected. For fiscal year ending June 30, 1991 the number of Plan participants dropped to 1,968. **Cmplt. § 53.**

C. Participant Statistics.

Counsel for the litigants have expended substantial time and effort in attempting to construct a mutually agreeable database of participant statistics. This has not been universally successful. As noted above, Class II and plaintiffs have a mutuality of interests in this action. Therefore, Class II adopts the characterization of the data as presented in plaintiffs' brief at pages 37-38. By permission and for purposes of consistency, portions of that brief are incorporated herein. Class II has not participated

in the compilation of these statistics and relies upon the representations of plaintiffs.

[From] [a] review of the briefs of Class I and plaintiffs it is apparent that the parties do agree to the following:

> 1. The total number of plan participants was 3,832 as of July 1, 1989, declined to 3,060 as of June 30, 1990 and to 1,968 as of June 30, 1991. Class I Brief at 21, 25, 50; Complaint ¶¶ 51-53; Class I Exs. 12-14 (census lists).
>
> 2. According to the Class I Brief, an additional 307 plan participants were added after July 1, 1989, including 252 additions in the 1989-1990 Plan year and 51 additions in the 1990-1991 Plan year. Class I Brief at 21, 27.[1]
>
> 3. The terminated participants include 396 who were fully vested, including 123 during the 1989-1990 Plan year and 273 during the 1990-1991 Plan year. Class I Brief at 26, 28, 50; Class I Exs. 12-14 (census lists).
>
> 4. The total number of participants for the 1989-1990 Plan year is 4,084 (the number at the beginning of the year, 3,832, plus the number added during the year, 252). The total number of participants for the 1990-1991 Plan year is 3,111

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[1] The 307 participant adjustment is a late revision by Class I. See Ex. 3. The Class I Brief does not include a separate listing or any other way of readily identifying those 307 new participants but Class I is in the process of compiling the records to support this assertion. Plaintiffs and Class II have tried to replicate that number without success. Rather than delay the briefing process, we assume for the purpose of this brief that the 307 count is correct. Class II reserves the right to challenge that calculation in our reply brief.

(the number at the beginning of the year, 3,060, plus the number added during the year, 51). For the entire two-year period, the total number of participants is 4,139 (the number at the beginning of the period, 3,832, plus the number added during the period, 307).

5. The total reduction in participation for the 1989-1990 Plan year is 1,024 (the total number of participants for the year, 4,084, minus the number remaining at the end of the year, 3,060). The total reduction for the 1990-1991 Plan year is 1,143 (the total number of participants for the year, 3,111, minus the number remaining at the end of the year, 1,968). The total reduction for the two-year period is 2,171 (the total number of participants over the two-year period, 4,139, minus the number remaining at the end of the period, 1,968).

Class I has proposed a series of adjustments to these numbers based on its review of certain underlying documentation provided by Sea Ray. Early in the discovery process, Class I indicated a significant discomfort with the statistical information provided by the employer. These adjustments and their applicability are more appropriately discussed subsequent to the analysis of the law contained hereunder.

D. Determination of Plan's Administrative Committee.

Having noted the decline in employment and participation levels, the Plan's Administrative Committee raised the issue in its meeting of June 12, 1992. **Plaintiff's Ex. IV.** On June 26, 1992 the Committee made a determination

that under the applicable facts and circumstances a partial termination of the Plan had not taken place. **Plaintiff's Ex. V.** As a result, the participants who experienced a termination of their employment with Sea Ray from 1989 through 1991 and who were not 100% vested in their account balances were entitled to a distribution of only the vested portion of their accounts. The nonvested portions would be considered to be forfeited and were to be reallocated to the remaining participants. **Id.** The reallocation was suspended pending judicial determination of whether there has been a partial termination. **Cmplt. §§ 61-62.**

III. LEGAL ANALYSIS

As noted, the central issue in this action is the determination of whether or not a partial termination has occurred as a result of the reduction in Plan participation.

A. History of Statute.

The concept of vesting through termination of a plan was initiated by Treasury regulations before ever appearing in statutory form. The termination of a plan as a vesting event was codified in 1962 in 26 U.S.C. § 401(a)(7). In essence the statute stated that the termination or discontinuance of contributions to a plan would act to render the employees accounts nonforfeitable. The legislative history stated

> [T]he bill precludes the possibility that contributions for employees which have been deducted for income-tax purposes may revert back to the employer. . . . This requirement should serve to

> prevent abuses resulting from termination of plans.

H.R.Rep. No. 378, 87th Cong., 1st Sess., reprinted 1962-3 C.B. 261, 269. The statute did not make mention of the concept of partial termination. This was formulated by Treasury Regulations in 1963 whereby termination was defined to include "both a partial termination and a complete termination of a plan." **Treas. Reg. § 1.401-6(b)(2) (1963).**

At the time, the stringent vesting schedules now required under law did not exist. Employers were allowed to require that the employee maintain employment under specific terms as a condition to vesting. Terminated employees often forfeited their entire account balances. The concern, as stated in the legislative history, was that "an employer could establish a forfeitable plan, enjoying the tax benefits flowing therefrom, and then terminate it, thus causing the assets to revert to the employer with favorable tax consequences." ***Halliburton Co. v. Commissioner,* 100 T.C. 216, 226 citing H.Rept. 87-378 at 16 (1961), 1962-3 C.B. 261.** Clearly the concern of the legislature was the prevention of abuse.

In 1974 a massive rewriting of the retirement plan law occurred under the Employment Retirement Income Security Act of 1974 ("ERISA"). **29 U.S.C. §§ 1001-1461.** As part of this legislation Congress enacted IRC § 411(d)(3) which provides that

> [A] trust shall not constitute a qualified trust under section 401(a) unless the plan of which such trust is a part provides that –

> (A) upon its termination or partial termination,
>
> . . . .
>
> the rights of all affected employees to benefits accrued to the date of such termination, partial termination, or discontinuance, to the extent funded as of such date, or the amounts credited to the employees' accounts, are nonforfeitable.

In 1977, the Secretary of the Treasury promulgated regulations that are stunning by their brevity and by the fact that they continue unamended despite continued revision of the statutory scheme under ERISA. Without the usual guidance of examples the Treasury stated

> (b) Partial Termination. (1) General Rule. Whether or not a partial termination of a qualified plan occurs (and the time of such event) shall be determined by the Commissioner with regard to all the facts and circumstances in a particular case. Such facts and circumstances include: the exclusion, by reason of a plan amendment or severance by the employer, of a group of employees who have previously been covered by the plan; and plan amendments which adversely affect the rights of employees to vest in benefits under the plan.

Treas. Regs. § 1.411(d)-2(b). The exclusion by severance of plan participants has become known as a "vertical partial termination". ***In re Gulf Pension Litigation*, 764 F. Supp. 1149, 1163 (S.D. Tex. 1991).** It is this type of termination with which we are concerned.

B. Interpretation of Statute.

Since passage of the statute and the implementation of the regulations, a substantial body of case law and administrative interpretation has been devoted to ascertaining what facts and circumstances are applicable in making a determination of partial determination.

1. Internal Revenue Service.

Through a series of revenue rulings and technical advice memoranda the Service traditionally took the approach that the termination rules existed to prevent abuse of the tax benefits of the law. **See TAM 6512108240A (Dec. 10, 1965) and TAM 7312286880A (Dec. 28, 1973); See also Rev. Rul. 73-284, 1973-2 C.B. 139 and Rev. Rul. 72-439, 1972-2 C.B. 223.** The majority of these rulings adhered to this anti-abuse character even in the face of high termination percentages.

In the 1980's the emphasis of the IRS changed to where greater weight is given as to whether a "significant percentage of employees were . . . excluded from participating in the plan." **IRS, *Plan Termination Handbook*** § 252(6). In Revenue Ruling 81-27 the IRS stated there was a point where the severance percentage could be so great as to preclude other considerations.

However, the Plan Termination Handbook still states that there are factors other than a reduction in participant levels which must be considered: (i) Whether the potential for reversion has been created or increased as a result of participant turnover; and (ii) Whether the possibility

for prohibited discrimination has increased. **Id., §§ 252(8)&(10).**

2. Caselaw – Factors to be Considered.

Much of the litigation involving partial termination has occurred in the 1980's. The vast majority of this law has acknowledged that the facts and circumstances test mandates a review of all aspects of the reduction in workforce. **See *Bruch v. Firestone Tire and Rubber Company*, 828 F.2d 134 (3rd Cir. 1987); *Kreis v. Charles O. Townley, M.D. & Assoc., P.C.*, 833 F.2d 74 (6th Cir. 1987); and *Sage v. Automation, Incorporated Pension Plan and Trust*, 845 F.2d 885 (10th Cir. 1988).**

a. Two Part Inquiry.

The opinion in *Kreis*, the controlling case in the Sixth Circuit, states there are two basic inquiries that must be made in applying the facts and circumstances test: (i) the effect on the plan of the exclusion of employees from participation; and (ii) the decision maker's motives.

A significant factor in the first inquiry is the percentage of plan participants who are involuntarily excluded. The Sixth Circuit acknowledged that the percentage of termination may be so high as to be solely determinative. ***Kreis v. Charles D. Townley, M.D., & Assoc., P.C.*, 833 F.2d at 80 citing *Bruch v. Firestone* and *Ehm v. Phillips Petroleum*, 583 F.Supp. 1113 (D.Kan. 1984).** However, the court clearly stated "as a general matter we must look beyond the mere percentages unless and until Congress or the Treasury Department provides otherwise." **Id.**

As part of the first inquiry, a determination should be made as to "the extent the Plan is affected financially by the discharges." **Id.** Terminations that represent a small percentage of employees may be significant if they disproportionately impact the financial viability of the plan.

The second inquiry focuses on the decision maker, i.e., did the employer exclude the plan participants "in a predatory effort to profit from subsequent forfeitures and/or diminished contribution requirements?" **Id. See also *Babb v. Olney Paint Co.*, 764 F.2d 240, 245 (4th Cir. 1985) and *Bruch v. Firestone Tire and Rubber Company*, 828 at 530.**

b. Percentage Test – the Numbers.

(1) Percentages Sustaining Partial Termination. The Sixth Circuit in ***Kreis*** engaged in a substantial review of the caselaw then in effect for the purpose of determining what percentages had been considered to be significant to the point of solely sustaining a finding of partial termination. The Court noted that the lowest percentage sufficient to find a partial determination was the 34% of ***Tipton & Kalmbach, Inc. v. Commissioner*, 83 T.C. 154 (1984).** ***Tipton & Kalmbach*** involved a multi-year time frame over which the workforce reduction occurred. In year 1 the reduction was 34% followed by a 51% reduction in year 2. The Tax Court determined that a partial termination occurred in each year.

It should be noted that the Tax Court rejected the argument that any factor other than percentage of participant terminations should be considered. **Id. at 161.**

Acknowledging that the Tax Court was inferring a broader purpose for the statutory provisions, the ruling states that the Congressional intent was the protection of employees from forfeiting their retirement benefits upon termination of a plan. **Id.** This position has not been supported by any other authority known to Class I and was subsequently reinterpreted by the opinion of the Tax Court in ***Halliburton v. Commissioner, supra,*** nine years later. Therefore, this ceiling is of dubious authority.

The *Tipton & Kalmbach* numbers are the lowest percentages that have been found to sustain a finding of partial termination. Normally, when a determination of partial termination is based solely on the percentage of participants terminated, those percentages exceed 50%. **See *Peter M. Boruta, M.D., P.C. v. Commissioner,* T.C. Memo. 1988-172 (66.66%); and Revenue Ruling 1-27, 1981-1 C.B. 228 (57.6%).** This would seem a logical analysis in that a percentage reduction greater than 50% in any one year represents the loss of a majority of participants.

(2) Percentages Insufficient for Partial Termination. The *Kreis* court also reviewed the highest percentages deemed to be insufficient to sustain a finding of partial termination. The court cited three examples: (i) 16.7%, ***Wishner v. St. Lukes's Hosp. Center,* 550 F.Supp. 1016 (S.D.N.Y. 1982)**; 13%, ***Taylor v. Food Giant, Inc. Salaried Employees Pension Plan,* No. C84-253A (N.D.Ga. Nov. 30, 1984)**; and 12.4%, ***Babb v. Olney Paint Co., supra.*** Based on this analysis, *Kreis* found that multi-year termination rates of 15% and 13.6% were not plan terminations. This has been further supported by the Tax Court in ***Halliburton Co. v. Commissioner, supra,*** 19.85%.

There is no statutory basis for the cutoff of the 20% floor. As noted by *Halliburton* the origin of the rule may well be a pre-ERISA report which was required to be filed with the IRS any time there was a drop of greater than 20% of plan participants. **See *Halliburton* at 237, fn 8.**

c. Anti-Abuse Factors.

The Third Circuit in *Bruch* stated the significance of the presence of abuse factors in the strongest terms

> We believe that the structure of the statute suggests that a partial termination should be found under § 411(d)(3) only if so many people have been terminated that the plan appears to have been created as a mechanism for deferring the recognition of income, and thereby reducing taxes, rather than as a mechanism for the provision of retirement benefits to employees.

***Bruch* at 151.** This is consistent with the legislative history of the statute and the concern that the liberal vesting rules of the 50's and 60's allowed for the abuse of the income tax system. The Third Circuit was firm on the necessity of a finding of abuse on the part of the employer. However, as noted above a substantial body of case law and administrative rulings has mitigated this opinion. The existence or nonexistence of employer abuse serves to slide the percentage scale rather than prevent or assure a finding of partial termination. **See *Kreis v. Charles O. Townley, M.D. & Assoc., P.C.*, 833 F.2d at 80, 81; *Halliburton Co. v. Commissioner*, 100 T.C. at 232.**

The Tax Court has acknowledged the sliding scale:

> Between the two extremes, where the percentage drop has not been sufficient in and of itself to establish that a partial termination has occurred, the surrounding facts and circumstances have been considered in conjunction with the percentage drop in order to decide whether the percentage drop is significant.

***Halliburton Co. v. Commissioner*, 100 T.C. at 237, citing *Kreis v. Charles O. Townley, M.D. & Assoc., P.C.* 833 F.2d at 79-80.**

Therefore, absent a percentage of terminations of less than 20%, which would mandate a finding that no partial termination occurred, and a percentage of terminations greater than 50%, which would mandate a finding that partial termination had occurred, the body of law requires that a balancing take place that determines the presence or lack of an abusive intent on the part of the employer. Where there is not a finding of abusive intent the threshold percentages of termination must necessarily be high to support a finding of partial termination. Where there is evidence of an abusive intent the threshold percentages of termination may be lowered to prevent the intended abuse.

d. Multi-year Terminations.

In those situations where terminations have occurred over a substantial period of time the courts have been willing to break the terminations down into separate groups for the purpose of calculating the appropriate percentages. The issue is whether the terminations occur

as the result of a single corporate event. **See *Halliburton*, 100 T.C. at 230; *Weil V. Retirement Plan Administrative Committee*, 750 F.2d 10, 12 (2nd Cir. 1984) ("Weil I").** A long-term corporate downturn associated with normal industry volatility is not considered to be a single event and may be measured in separate years. ***Tipton & Kalmbach, Inc.*, 83 T.C. at 155; See also *Kreis v. Charles O. Townley, M.D. & Assoc., P.C.*, 833 F.2d at 83.** The IRS has also accepted the concept of segregating multiple year terminations into separate percentage breakdowns for analysis. **See *Plan Termination Handbook* § 252(5)(c).**

e. Inclusion of Participant Classes.

In computing the measuring percentages the most difficult issue is the determination of the various classes that the participants fall into and the usage of those classes in the computations. The Tax Court in *Halliburton* reviewed the various classes constituting the participants in the plan there in question.

The first group of these were classes of separated employees who would not be counted in the termination percentages. These included deaths, normal retirements and terminations for cause. The litigants had agreed prior to trial that these participants would be excluded. The Tax Court reviewed this agreement with approval stating that the terminations were not "attributable to Halliburton's reductions in force and so . . . not affected by such action." ***Halliburton Co. v. Commissioner*, 100 T.C. at 238, citing with approval *In re Gulf Pension Litigation*, 764 F.Supp. at 1168 and *Morales v. Pan Am. Life Insurance Co.*, 718 F.Supp. 1297, 1302 (E.D.La. 1989).**

In making a determination as to partial termination, the focus of the review is on the plan participants who were excluded from the plan in connection with the corporate event. **See *Kreis v. Charles O. Townley, M.D. & Assoc., P.C.*, 833 F.2d at 79.** Therefore, a question may arise as to participants that left employment voluntarily but who may be considered to have left because of their concern over the financial health of the employer. The regulations imply that only employer-initiated terminations should be counted due to the term "severance by the employer" of plan participants. **See Treas. Reg. § 1.411(d)-2(b)(1); and *Halliburton Co. v. Commissioner*, 100 T.C. at 240.** However, the courts have acknowledged a possibility that a constructive discharge may take place in those circumstances where the employee resigned due to intolerable working conditions created by the employer, ***Kreis v. Charles O. Townley, M.D. & Assoc., P.C.*, 833 F.2d at 81-82**, or it is clear that there is no prospect for continued employment. ***Collignon v. Reporting Services Co.*, 796 F.Supp. 1136, 1141-1142 (C.D.Ill. 1992); *Morales v. Pan Am. Life Insurance Co.*, 718 F.Supp. at 1303.** The Court in *Halliburton* concurred with these prior decisions and excluded these employees in its analysis and clarifying the issue by stating

> [S]ome employees might leave their jobs of their own accord, even when economic situations are bad, because of dissatisfaction with their situations or for personal reasons. The partial terminations rule was not meant to protect such persons – they do not have the same expectation with respect to the vesting of their accrued benefits that involuntarily separated employees do.

Moreover, vesting their benefits would not necessarily deter abuse by employers

***Halliburton* at 241.** The Tax Court concluded that simple concern over the future was insufficient to sustain a claim of constructive discharge. The employer must have overtly and purposely created a hostile and unbearable work environment or else the employee must have actual notice that his employment is about to be terminated such as an actual closure notice.

Any employer has a turnover rate that may be derived from historical data. **See *Plan Termination Handbook* § 252(6)-(7).** This would be an appropriate adjustment to the computations to be performed in this action. Class II concurs with plaintiffs' decision to infer a turnover rate at this time but reserves the right to do so on the event the Court should deny the Class II motion.

f. Formula for Computation.

In determining the percentage of terminated participants, the Court must compute the significant percentage fraction, the denominator of which is the total number of plan participants at the beginning of the time frame in question plus the number of participants added during the time frame. The numerator is the number of plan participants terminated from the plan during the time frame minus those excludable employees. ***IRS Plan Termination Handbook*, § 252(7).** The fraction is as follows:

$$\frac{\text{Total Reduction minus Excludable Employees}}{\text{Total Number of Participants}}$$

IV. APPLICATION OF LAW

A. CORPORATE EVENTS.

From the facts presented it is obvious that the overall triggering event was a significant economic downturn in the recreation boating industry that began in 1989. The downturn was rapid and severe and was reflected by substantial reductions in the workforce and the closing of three manufacturing facilities. By January 1990, Sea Ray had stabilized its workforce and had in fact initiated some recalls of personnel. However, upon the imposition of the luxury tax an additional drop of sales occurred which resulted in significant terminations at the Merritt Island and Palm Coast facilities and the closure of the Oxford facility. These terminations are graphically presented in Ex. 4. The distinct peaks and valleys of the graphs show the concentrated impact of two distinct events occurring in two separate fiscal years.

Under the holding of *Tipton & Kalmbach* these events should be segregated and the termination percentages computed for the two separate fiscal years.

B. COMPUTATION OF PERCENTAGES.

As noted hereinabove the parties have agreed on the following numbers:

Plan Year	Number of Participants	Participant Terminations
1989-1990	4,084	1,024
1990-1991	3,111	1,143

The question still to be resolved is the adjustments to the statistics. As noted above Class II does not seek at this time to imply a normal turnover percentage.

The dispute does center around individuals who voluntarily terminated employment during the time frame in question. A great deal of effort has been expended in reviewing source documents, particularly the Change of Employee Status forms which were designed for use by the personnel directors of each facility. As Class I indicates, each facility manager was given a great deal of autonomy in managing his/her personnel matters. **Class I brief at 18.** As a result certain aspects of record keeping were irregular at best. The Change of Status forms were used in varying amounts of detail and did not prove to be universally dispositive of the issue. Based on anecdotal information received by counsel for Class I through personal contact with various members of the class, Class I was concerned that the termination categories were not accurate.

Much of Class I's concern is generated by the incompleteness of the Change of Status forms. However, one fact remains clear. The Change of Status forms were internal documents used by individual plant managers. The Plan census forms on the other hand were the documents prepared company wide which formed the basis of IRS reports and account allocations and which were based on payroll information. There has not been any allegation known to Class II that errors have been committed in the accounting for individual participant accounts. As such these documents must be considered to be the most accurate of the source materials.

Based on its concern over discrepancies between the Change of Status forms and the Plan census forms Class I proposes a drastic resolution. All employees who voluntarily terminated employment from July 1, 1989-June 30, 1991 should be treated as terminated participants. This is both drastic and insupportable. While Class I points out that many employees would justifiably seek employment elsewhere during the constriction of the workforce this does not fit the definition of a constructive discharge as set forth under the caselaw.

Therefore, Class II does adopt the adjustments proposed by plaintiffs in plaintiffs' Ex. I and referred to in plaintiffs' brief at 39. Because of the late adjustments received from Class I, the computations of plaintiffs result in greater percentages of termination than do the computations of Class II.

1989-1990:

$$\frac{\text{Total Reduction minus Excludable Terminees}}{\text{Total Number of Participants}} = \frac{(1{,}024 - 373)}{4{,}084} = 15.94\%$$

1990-1991:

$$\frac{\text{Total Reduction minus Excludable Terminees}}{\text{Total Number of Participants}} = \frac{(1{,}143 - 275)}{3{,}111} = 27.9\%$$

1989-1991:

$$\frac{\text{Total Reduction minus Excludable Terminees}}{\text{Total Number of Participants}} = \frac{(2{,}167 - 648)}{4{,}139} = 36.7\%$$

Plaintiffs have provided computations of the termination percentages based on the assumption of Class I that voluntary terminations should be included. While Class II does not agree with that position for the purposes of

clarity and in light of the changes reflected in Ex.3, Class II provides the same alternative Calculation II.

1989-1990:

$$\frac{\text{Total Reduction minus Excludable Terminees}}{\text{Total Number of Participants}} = \frac{(1{,}024 - 102)}{4{,}084} = 22.6\%$$

1990-1991:

$$\frac{\text{Total Reduction minus Excludable Terminees}}{\text{Total Number of Participants}} = \frac{(1{,}143 - 109)}{3{,}111} = 33.2\%$$

1989-1991:

$$\frac{\text{Total Reduction minus Excludable Terminees}}{\text{Total Number of Participants}} = \frac{(2{,}167 - 211)}{4{,}139} = 47.3\%$$

C. ANALYSIS OF COMPUTATIONS.

The record is clear on the corporate history of Sea Ray. The reductions in workforce were the result of outside economic factors. These factors were not a single event rather they were a combination of events that occurred sequentially. The initial downturn in the small craft boating industry did not affect the luxury yacht sales. The industry did remain in the doldrums during the entire time frame in question, however, this was enhanced by the drastic drop in luxury yacht sales. A review of the sales figures show the initial drop of sales from 1989 to 1990 was 70% of the overall decrease during the 1990 and 1991 fiscal years. The drop in yacht production was the most significant portion of the 1991 decrease in light of the 40% manpower reduction that took place at Merritt Island and Palm Coast. There were two significant corporate events that must be measured separately.

When the terminations are measured in two phases the reductions in work force are 15.9% in 1989-1990 and 27.9% in 1990-1991. The 15.9% reduction is within the rule of thumb that terminations below 20% cannot constitute a partial termination. The 27.9% rate of terminations for 1990-1991 do exceed the 20% safe-harbor. However, there is no evidence that the reduction in workforce was the result of anything but a downturn in the economic cycle. As such there is no evidence that the anti-abuse considerations of the statutory, regulatory or case law would apply. Therefore, the sliding scale of percentage should be applied.

Since there is no abusive character to the terminations the sliding scale approach would find the 27.9% rate for 1990-1991 insufficient for a finding of partial termination, particularly in light of the previous low percentage of 34% cited in *Tipton & Kalmbach, Inc. v. Commissioner*, supra. It should also be noted that the 34% of *Tipton* was sustained with a second year termination rate of 51%. In this case the termination rates are a consecutive 15.9% and 27.9%. The two year termination rate of 36.7% compares favorably with the one year termination rate in *Tipton*.

Therefore, Class II respectfully submits that a partial termination of the Plan did not occur during the time frame July 1, 1989 to June 30, 1991. As such the determination of the Committee that a partial termination had not occurred was correct and within the standards of applicable law.

V. STANDARD OF REVIEW

Class II adopts the arguments and position of Plaintiffs with respect to the appropriate standard of review.

VI. CONCLUSION

Based on the conclusions of law and fact contained herein, Class II defendants respectfully request that this Court grant the cross-motions for summary judgment filed by Class II and by Plaintiffs and deny the Class I defendants motion for summary judgment.

Respectfully submitted,

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